MAINFRAME ENTERTAINMENT, INC.

ANNUAL REPORT 2002

02

MAINFRAME™
ENTERTAINMENT, INC.

Spider-Man

CORPORATE PROFILE AND OPERATING HIGHLIGHTS

Barbie in the Nutcracker

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CORPORATE PROFILE

Mainframe Entertainment Inc. is one of the world's most prolific producers of computer animation for television and direct to videos and is expanding into long-form CGI for feature films, commercials and interactive entertainment.

Mainframe has produced over 230 half hours of computer animation since its inception in 1993. In addition to its award winning *Barbie® in the Nutcracker* direct-to-video feature, the Company's recent projects include two original *ReBoot®* TV movies and 40 half-hours of the *Heavy Gear™* television series. Founded in 1993, the Company employs over 220 artists, animators, technicians and production personnel, and has won many prestigious awards for its creative and technical innovations, including an induction into the Smithsonian Institute.

The Company's highly skilled creative team and technical staff have established themselves as leaders in the field of computer animated entertainment. The Company levers its position as a world leader in the development, production and distribution of children's programming using CGI, allowing it to access the large and growing markets for children's programming, entertainment and licensed products.

Mainframe operates from its 77,000 square foot facility in Vancouver, B.C., Canada. The Company continues to develop proprietary software to address the specific technical requirements of high-volume CGI production, allowing the Company to meet the demands of serial-length television production without sacrificing visual quality.

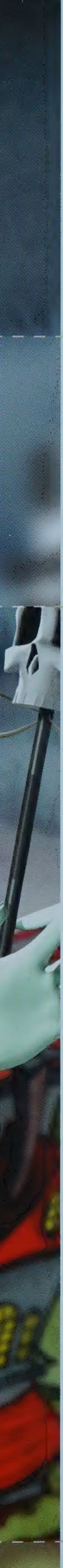
Mainframe Entertainment is a publicly traded Company on The Toronto Stock Exchange under the symbol MFE.

OPERATING HIGHLIGHTS

- Delivered 33 episodes of animated programming increasing total overall production to 236 episodes.
- Completed delivery of 26 episodes of *Action Man™*, 40 episodes of *Heavy Gear*, and 9 episodes of *Max Steel™*. All are half hour episodes.
- Delivered two made-for-TV movies reviving the *ReBoot* franchise which aired on YTV in Canada and Cartoon Network in the U.S. TV Loonland will distribute the movies in Europe and Alliance Atlantis will distribute throughout the rest of the world.
- Delivered first Barbie direct-to-video, entitled *Barbie in the Nutcracker*, for Mattel Inc. in July 2001.
- *Barbie in the Nutcracker* won the prestigious Best Animated Video at the 2001 Video Premiere Awards in Los Angeles.
- Commenced production of 13 half-hour episodes of the animated *Spider-Man™* TV series for Columbia Tristar Domestic Television's Adelaide Productions. Final delivery is expected early in 2003.
- Commenced production of *Barbie as Rapunzel*, the second installment of the Barbie direct-to-video features, for Mattel Inc. Final delivery took place in July 2002.
- Since year-end commenced production on the third Barbie direct-to-video feature for Mattel Inc. for delivery in May 2003.
- Entered into co-venture with Tony Hawk, the world-renowned professional skateboarder, to develop and produce an animated TV series featuring the "extreme sports" star.
- Brett Gannon, previously the Company's Chief Financial Officer, was appointed President in September 2001.
- Mark Fleischer (from Fleischer Studios) was appointed President of Mainframe USA, the Company's Los Angeles-based subsidiary, to spearhead the expansion of the Company's presence in Los Angeles.

MESSAGE TO SHAREHOLDERS

Scary Godmother



Fiscal 2002 was a year of transition for Mainframe Entertainment, Inc. Coming off one of our best years ever, we were eager to continue to build on the foundation that had been put in place over the past several years.

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We started the year well: completing and delivering the last 3 episodes of the 26-episode series *Action Man* for Hasbro Properties Group and completing and delivering the final 13 episodes of the 40-episode series *Heavy Gear* for Sony Pictures Entertainment. By the second quarter we had delivered the first full-length Barbie movie for Mattel Inc., *Barbie in the Nutcracker*, which won the prestigious Best Animated Video at the 2001 Video Premiere Awards, and we had started production on the fourth season of *ReBoot*. Additionally, we were awarded the production of the final episodes of *Max Steel* for Sony Pictures Entertainment, a series which began production at a competing studio.

Internally we focused on developing proprietary properties that could generate multiple revenue streams while continuing to provide the necessary services relative to our highly valued customer driven properties. During the second quarter it became apparent that although the Company was in development of several properties it was unlikely that any of these projects would be delivered during the fiscal year. Furthermore, discussions with Sony Pictures Entertainment relative to our involvement in the planned *Spider-Man* television series were progressing well and, given the tremendous success of the first Barbie video we were confident that a second project with Mattel Inc. was very likely to follow.

The probable production dates of these projects indicated that the likelihood of significant additional deliveries for the balance of the fiscal year was low and that certain restructuring initiatives needed to be taken. Our resulting customer driven service work was literally cut in half and we were forced to under go significant overhead reductions at all levels including that of senior management. As part of this restructuring I was named President in September of 2001 and although the fiscal year results did not look encouraging, the Company maintained its belief that additional projects would be signed for delivery in the following fiscal year. Both *Spider-Man* with Sony Pictures Entertainment and *Barbie as Rapunzel* with Mattel Inc. began production during the year. Unfortunately these projects did not impact the year's results as deliveries do not take place until Fiscal 2003.

For the year ended March 31, 2002 the Company achieved revenues of $22.5 million compared to $39.9 million for the year ended March 31, 2001. As a result of the decreased activity through the studio and revaluations of our investments in film and television programming the loss for the year ended March 31, 2002 was $18.9 million or $1.11 per share compared to earnings of $2.4 million or $0.14 per share a year earlier. A detailed analysis of these results can be found in Management's Discussion and Analysis presented later in this report.

Since the year-end the Company has completed production and delivered *Barbie as Rapunzel* to Mattel Inc. and *Spider-Man*, to be aired on MTV in 2003, is now in full production. These customer driven projects continue to provide the necessary cash flow to help fund the Company's development and eventual production of proprietary properties.

The Company continues to invest in existing, as well as new properties, that have the potential to generate multiple revenue streams. Amongst those properties currently in development is *Tony Hawk's Feasters*™, where the lead character will be based on the world-famous skateboarder. The Company is working together with Kids' WB! to develop this property for broadcast in the fall of 2003 and has received much interest both domestically and internationally from broadcasters as well as potential licensees in the various merchandising categories. Other properties in development include *Dots Bots*™, *Betty Boop*™, *Scary Godmother*™, *Family Values*™ and *Wubbies World*™.

Looking to the future, we remain enthusiastic about our development slate of properties and thankful for our valued customer relationships. Fiscal 2002 has been a transition year not without its challenges and we expect more of the same for Fiscal 2003. We began Fiscal 2003 in full production of our second Barbie video and have signed a deal with Mattel Inc. to produce a third. We are also in full production of the television series *Spider-Man* and are hopeful that our efforts will result in additional opportunities for Fiscal 2003 deliveries as we progress through the year. As we continue to develop our own properties we increase our ability to project our activities over a longer period and current indications are that Fiscal 2004 output will be better than Fiscal 2001, our best year.

I would like to extend my gratitude to my team of hard working, enthusiastic employees for their unbridled creativity, their desire to be the best, and dedication to our success.

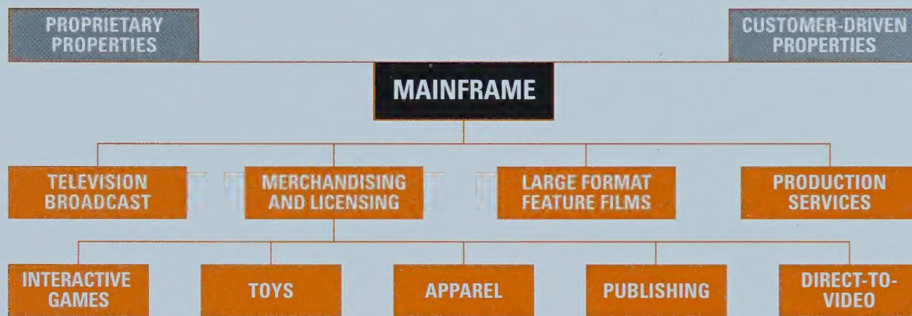
I would also like to thank all of our customers, shareholders and our Board of Directors who have continued to support our vision.

Mr. Brett Gannon
President

OPERATIONAL OVERVIEW

The Company continues to focus on its growth strategy of exploiting its digital database across all media

to extend the reach of the projects and brands it works on. The Company continues to concentrate on the creation and acquisition of proprietary properties. Investments in property acquisition, creation and development allow for exploitation of multi-year, multi-channel licensing revenue which lowers the risk and diversifies the revenue base. This was evidenced by the Company's commitment to produce and deliver Season IV of *ReBoot* and the acquisition and development of properties such as *Tony Hawk*.



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PRODUCT DEVELOPMENT

MOTION CAPTURE

RAPID PROTOTYPING

The Company will also selectively pursue customer-driven production services. The Company has established excellent relationships with companies like Mattel, Sony, Hasbro, and Lego and continues to enhance these relationships. Recently secured projects such as the third Barbie video for Mattel and the animated *Spider-Man* television series for Sony reflect Mainframe's success in securing and delivering high profile, high quality customer driven projects.

Mainframe's primary advantage in maximizing investment relates to the fundamental versatility of digital animation. Once characters, props, sets and environments have been created in digital format they are stored in a database and can be called up again and again and repurposed for new projects such as computer games, internet applications, direct-to-video, large format feature films and TV work.

Unlike traditional animation, a digital database is not hampered by being created solely for one project. Digital assets are extremely versatile, and, after the initial investment of creation, simply generate revenue each time they are used.

3D ANIMATION LEADERSHIP □ Mainframe is one of a few companies in the world that have been able to consistently complete 100% computer generated animation for weekly television on a timely basis. To date, over 5500 minutes of animation have been completed.

Mainframe continues to produce award-winning, animated programming that utilizes the Company's powerful base of proprietary software and sophisticated production methods.

TOP ANIMATORS □ Creative freedom, Company growth, location and challenging creative work are critical reasons why the best animators choose to work, and stay, at Mainframe. The environment, with its unique corporate culture, caters to any animator, modeler, editor or technical director who is keen to work on industry leading animation. At Mainframe, management, producers and directors encourage diversification of talent and promotion from within.

TOP SOFTWARE □ Mainframe has a clear technological advantage, our proprietary software. Mainframe believes its success in creating, developing and producing its programs is dependent on its ability to utilize technology in creative and cost-effective ways. This is the key reason Mainframe employs over a dozen highly skilled programmers to develop proprietary software. The Company will continue to invest in resources required to create new and refine existing proprietary software. We house state-of-the-art production equipment that is necessary to generate greater productivity among Mainframe's animators and more visually stunning animation.

Mainframe boasts impressive CGI animation thanks to continuing research and upgrades of proprietary software programs such as GRIN, which allows animators to quickly, and realistically, synchronize characters' facial expressions with dialogue. Currently, the Company is making significant investments in continued research to further develop proprietary software for large format feature films.

CURRENT PRODUCTIONS

BARBIE® AS RAPUNZEL □ This is the second Barbie direct-to-video feature film being produced for Mattel Inc. and follows on from the success of *Barbie in the Nutcracker. Barbie as Rapunzel* was delivered in July 2002 with retail sales beginning in late Fall 2002. Production has started on the third Barbie video which will be delivered May 2003.

SPIDER-MAN™ □ This is produced for Columbia Tristar Domestic Television's division Adelaide Productions. The television series follows on from the success of the feature film that was released earlier in the year. Sony is handling distribution of the series to broadcasters. Delivery will take place late in 2002 through early 2003 and will air on MTV starting early in 2003.

IN DEVELOPMENT

TONY HAWK™ □ *Tony Hawk's Feasters,* being developed by Mainframe, Kids' WB! and Hawk, centers on the action sports phenomenon sweeping North America and targets the young male demographic of boys 11 to 14. Tony Hawk will serve as Executive Producer on the show which will feature many of the impressive stunts and tricks that have thrilled Hawk's fans around the world. Creators are looking to feature a lead character based on the famous skateboarder, as well as a group of kids who look up to him and become involved in various capers. Production is expected to start early in 2003 with delivery for the fall of 2003.

DOT'S 'BOTS™ □ This series has a completely different visual style from anything Mainframe has ever produced. The series follows the story of a 12 year old girl who masterminds the creation of robots from cast-off toasters and other household rejects.

SCARY GODMOTHER™ □ The Company is developing this property initially as a one-hour Halloween special featuring 3D characters on water-coloured backgrounds, based on the Jill Thompson comic book series. Aimed primarily at girls, ages 8 - 11, Scary Godmother features a fearless little girl, her clutzy, witch-like godmother and a host of spooky monsters.

WUBBIES WORLD™ □ Mainframe has an exclusive agreement with Wubbies World International, Inc. to develop a pre-school television series. Mainframe will develop 26 half-hours of computer animated programming for the series based on the Wubbies characters, and will also participate in all merchandising and licensing of the property. *Wubbies World* was developed by John M. Mokrenko and Christine Usvaltas of Toronto, Canada.

BETTY BOOP™ □ In collaboration with Fleischer Studios, Mainframe continues to develop a new television series based on the perennially popular *Betty Boop* property. The new series will present Betty in new and exciting situations, making her as relevant for audiences today as she was 70 years ago. In addition, King Features will work with Mainframe and Fleischer Studios to translate the modern Betty Boop character to a variety of products.

Tony Hawk's Feasters

FAMILY VALUES™ □ Together with Honest Entertainment, who brought you the off-beat characters of *Fido Dido* and *Angela Anaconda*, the Company will develop this new series, which was created by and written by Tom Brady (*The Simpsons, The Critic*) and Joanna Ferrone (co-creater of *Fido Dido* and *Angela Anaconda*) and anticipates using collage illustration production techniques.

PREVIOUS PRODUCTIONS

REBOOT® □ The original series was produced in cooperation with YTV Canada Inc. and Alliance Multimedia. The series was the first ever half-hour weekly TV show produced entirely in computer animation and was Mainframe's cornerstone production. With this series Mainframe proved its production methodology for producing 100% CGI television on a weekly basis without sacrificing visual quality.

Between 1994 and 1998 the series achieved critical and public success, winning several Gemini and Worldfest Houston awards, a Smithsonian Induction and numerous prizes from festivals around the world. Three seasons or 39 episodes were completed and the show continues to air in Canada, the U.S., and other international markets.

Mainframe recently delivered two 90-minute made for TV movies which aired on YTV in Canada and on Cartoon Network in the United States. The first movie, *Daemon Rising*, picks up where season three of the TV series finished. A major re-launch of the *ReBoot* toy line by Irwin Toys, along with several other merchandising tie-ins followed. Alliance Atlantis and TV Loonland, who distributed the first three series, are handling international distribution of this series.

BEASTIES™ (BEAST WARS™ IN THE U.S.), BEAST MACHINES □ *Beasties* (*Beast Wars-Transformers in the U.S.*) - was produced in partnership with Hasbro Properties Group and YTV Canada, Inc. The series, which ran for three seasons, was the number one syndicated series in its timeslot for children aged 2-11 years in the U.S. and was one of YTV's top-rated shows. In 1999 we produced 26 episodes of in the spinoff series of *Beast Wars*, known as *Beast Machines*, which also garnered number one ratings in its time slot with boys aged 2 - 11 in the U.S.

SHADOWRAIDERS™ (WAR PLANETS™ IN THE U.S.) □ This series was produced in partnership with U.S. toy manufacturer Trendmasters, Inc. and YTV Canada, Inc. The series launched in September 1998 in Canada, on national cable broadcaster YTV and was syndicated through Summit Media Group in the U.S. Foreign distribution is handled by Alliance/Atlantis.

Twenty-six episodes were completed.

WEIRD-OHS™ □ This squash and stretch comedy series was produced in partnership with YTV Canada, Inc. Thirteen episodes aired on Fox Family and YTV in September, 1999.

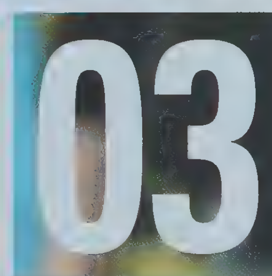
CASPER'S HAUNTED CHRISTMAS™ □ This direct-to-video feature film was produced and delivered by June 2000 for Harvey Entertainment. Home video sales began in November 2000 across North America with distribution being handled by Universal Entertainment.

BARBIE® IN THE NUTCRACKER □ This direct-to-video feature film was produced for Mattel Inc. The film features motion captured dance performances by the New York City Ballet along with keyframe character animation. The show was delivered in July 2001 and won the Best Animated Video at the 2001 Video Premiere Awards.

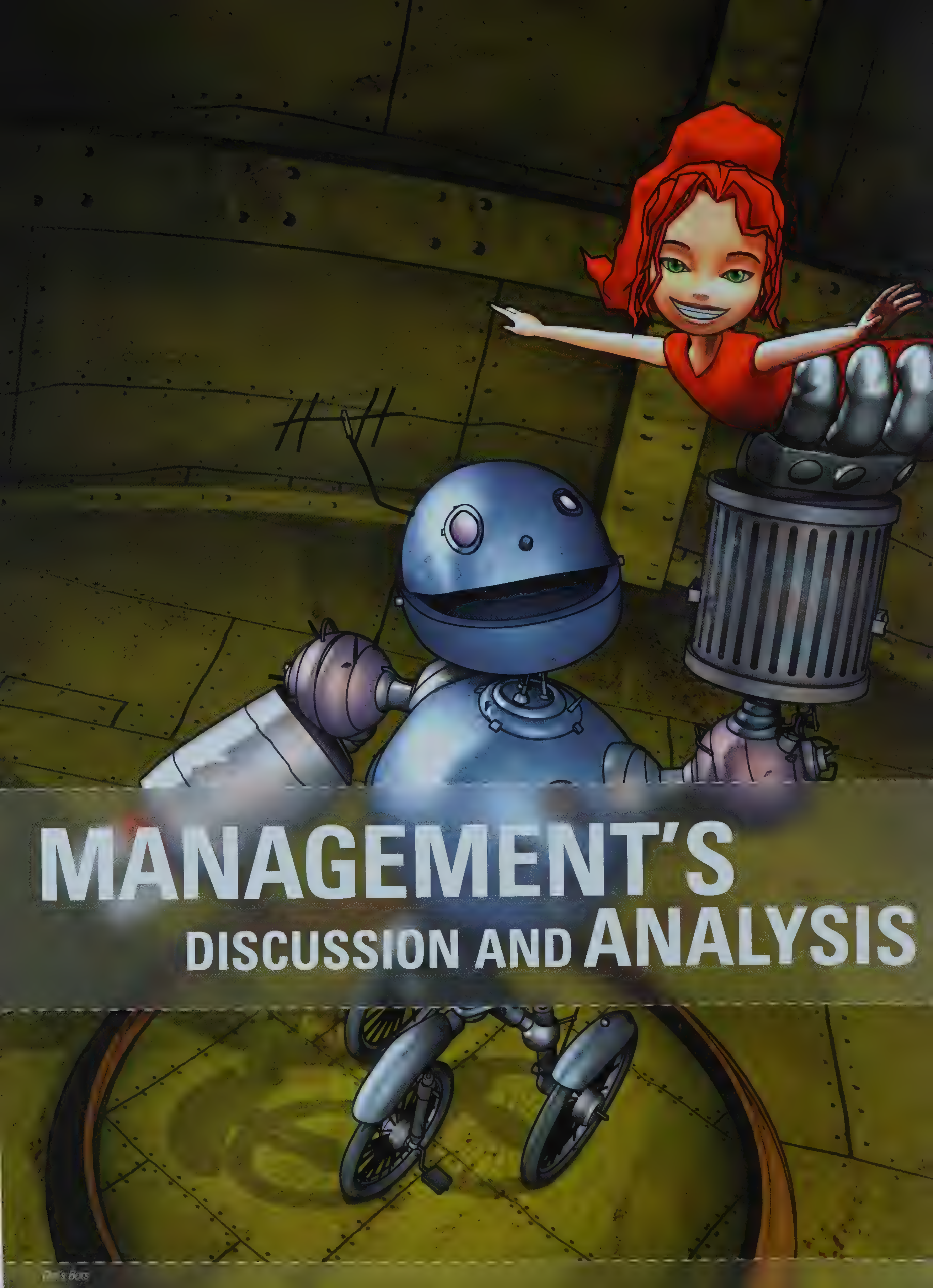
ACTION MAN™ □ Produced in collaboration with Hasbro Properties Group, twenty-six episodes were delivered beginning May 2000 and completing August 2001. The series aired in a regular weekly timeslot on Fox TV and YTV. SABAN NV International is managing international distribution.

HEAVY GEAR™ □ Produced for Sony Pictures Entertainment division Adelaide Productions, the original order for 26 episodes was extended to total of 40 episodes. Sony is handling distribution of the series to broadcasters. Final delivery took place in September 2001. The Company handles Canadian distribution and the show is slated for broadcast on YTV during 2002.

MAX STEEL™ □ Produced for Sony Pictures Entertainment division Adelaide Productions, the delivery of the nine episodes completed the series started by a competing studio. Final delivery took place in November 2001.



MANAGEMENT'S DISCUSSION AND ANALYSIS



Mainframe Entertainment is one of the world's foremost computer animation studios, producing long-form CGI for television, large format feature films, direct-to-video features and interactive entertainment. Founded in 1993, the Company employs over 220 artists, animators, technicians and production personnel, and has won many prestigious awards for its creative and technical innovations, including an induction into the Smithsonian Institute.

The Company currently trades on the Toronto Stock Exchange under the symbol "MFE".

REVIEW OF OPERATIONS

($ millions except per share information)	**2002**	2001
Delivered Episodes		
TV	**33**	50
Video	**1**	1
Revenue	**$22.5**	$39.9
EBITDA	**($3.5)**	$8.2
Net Income	**($18.9)**	$2.4
Earnings(loss) per share	**($1.11)**	$0.14

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REVENUE Revenues for the year ended March 31, 2002 decreased by $17.4 million to $22.5 million compared to the $39.9 million achieved for the year ended March 31, 2001. During the year the Company delivered a total of 33 television episodes and one direct-to-video production. These were comprised of 3 episodes of *Action Man*, 13 episodes of *Heavy Gear*, eight episodes of *ReBoot*, nine episodes of *Max Steel* and the direct-to-video production *Barbie in the Nutcracker*.

The significant decrease in revenue can be attributed to fewer deliveries, 33 in Fiscal 2002 compared to 50 in Fiscal 2001. Additionally, average episodic revenues decreased significantly over the previous year due to a change in the mix of episodes delivered. Properties that are proprietary in nature generally yield lower revenues than customer driven properties on initial delivery however over the longer term tend to result in higher overall revenue. Last year none of the episodes delivered were proprietary in nature.

Revenues for the year ended March 31, 2001 increased by $8.0 million to $39.9 million compared to the $32.0 million achieved for the year ended March 31, 2000. Although episodic deliveries were lower in Fiscal 2001 than Fiscal 2000, revenues exceeded Fiscal 2000 as a result of the delivery of the Company's first direct-to-video and significant increases in investment income and merchandising and licensing revenues.

PRODUCTION COSTS Production costs in Fiscal 2002 decreased to $21.1 million from $27.2 million in Fiscal 2001 mainly as a result of fewer deliveries.

As a percentage of revenue, production costs were 93.8% in Fiscal 2002 as compared to 68.1% in Fiscal 2001. With costs relating to the maintenance of the Company's facilities and computer hardware being fixed in nature, the reduced levels of activity in the current year compared to the previous year resulted in significantly higher production costs when expressed as a percentage of revenue.

Production costs in Fiscal 2001 increased to $27.2 million from $21.7 million in Fiscal 2000 largely due to the delivery of the Company's first direct-to-video production. As a percentage of revenue, production costs were 68.1% in Fiscal 2001 as compared to 68.4% in Fiscal 2000. Similar levels of activity in Fiscal 2001 compared to Fiscal 2000 resulted in similar production costs as a percentage of revenue.

SELLING GENERAL AND ADMINISTRATIVE EXPENSES Selling General and Administrative (SG&A) expenses remained relatively constant at $4.8 million in Fiscal 2002 compared to $4.5 million in Fiscal 2001. During the second quarter it became apparent that the Company would not generate the levels of activity originally planned and as a result measures were taken to significantly reduce overhead levels. Given the one time costs attendant to these reductions the majority of the benefits will be realized in the following fiscal year. Additionally, in line with the Company's strategy to focus on proprietary properties, as well as increase its presence in its major markets additional investments in the sales and marketing infrastructure in Los Angeles were made during the year.

SG&A expenses increased to $4.5 million in Fiscal 2001 compared to $4.3 million in Fiscal 2000. This increase was due primarily to the increase in selling expenses as the Company began to aggressively market the release of *ReBoot IV*.

DEPRECIATION AND AMORTIZATION Depreciation and amortization for the year ended March 31, 2002 was in line with the previous fiscal year and breaks down as follows:

($ millions)	**2002**	2001	Change
Depreciation of capital assets	**3.4**	3.3	0.1
Amortization of investments in TV and film	**0.7**	0.5	0.2
Amortization of deferred finance charges	**0.5**	0.5	0.0
Total	**4.6**	4.3	0.3

Depreciation and amortization expense for the year ended March 31, 2001 was $4.3 million compared to $3.5 million for the same period ended March 31, 2000. This increase was principally attributed to a full year's amortization of the cost of issuing debentures in Fiscal 2000.

INTEREST EXPENSE Interest expense on capital leases remained constant at $0.4 million during the years ended March 31, 2002 and March 31, 2001. Interest on convertible debentures also remained constant at $0.4 million in Fiscal 2002 and Fiscal 2001. Interest and accretion on convertible debentures increased to $1.5 million in Fiscal 2002 compared to $0.8 million in Fiscal 2001. In Fiscal 2001 the Company capitalized to Production in Progress certain interest and accretion on debt specifically related to productions. During the current year, a portion of this debt was repaid and the relationship to specific productions was removed for the remaining unpaid balance. Consequently interest and accretion that would have been capitalized was now expensed against earnings. Only $0.2 million of interest and accretion was capitalized to Productions in Progress (see note 5 to the Financial Statements). Also during the year, the Company issued $1.0 million in convertible debentures instead of paying cash interest (see note 9 to the Financial Statements).

Interest expense on capital leases remained constant at $0.4 million during the year ended March 31, 2001 and March 31, 2000. Interest on convertible debentures also remained constant at $0.4 million in Fiscal 2001 and Fiscal 2000. Interest and accretion on convertible debentures increased to $0.8 million in Fiscal 2001 compared to $0.6 million in Fiscal 2000. The increase was attributed to the first full year of interest and accretion on the debentures issued in July 1999. During the year, the Company issued $1.1 million in convertible debentures instead of paying cash interest (see note 9 to the Financial Statements) and capitalized $0.9 million of interest and accretion to Productions in Progress (see note 5 to the Financial Statements).

OTHER EXPENSE (INCOME)

(in millions of dollars)	**2002**	2001	Change
Realized foreign exchange gain	**(0.1)**	(0.5)	0.4
Other interest	**0.2**	0.1	0.1
Total	**0.1**	(0.4)	0.5

A significant amount of the Company's revenues are denominated in U.S. dollars which serve to offset expenditures which are also made in U.S. dollars. The Company's exposure to exchange rate fluctuations has not significantly changed over the prior year.

WRITE DOWN OF INVESTMENT IN FILM AND TELEVISION PROGRAMMING

(in millions of dollars)	**2002**	2001	Change
Completed programming	**3.1**	0.0	3.1
Productions in progress	**2.9**	0.0	2.9
Abandoned development projects	**2.4**	0.3	2.1
Total	**8.4**	0.3	8.1

In accordance with Company policy, each year the Company reviews the carrying value of its investments in various projects by estimating the expected future revenue streams. During this process the Company determined that expected revenues relating to some of its projects were significantly lower than had been originally anticipated. As a result the Company determined that the fair value of these investments was less than the carrying value and that a write down of approximately $3.1 million was appropriate.

Also during the year ended March 31, 2002 the Company determined that certain costs capitalized to Productions in Progress primarily relating to Gulliver's Travels™ were impaired and these costs were written down. During the year the project took on a new creative direction which rendered certain original investments obsolete.

The increase in the charge for abandoned projects relates to certain projects that have not been set for production within the three-year period stipulated by the Company's accounting policy.

BALANCE SHEET

LIQUIDITY AND CAPITAL RESOURCES The composition of the Company's assets and its shareholders' equity over the last three years is illustrated below:

(in millions of dollars)	**2002**	**% of total assets**	**2001**	**% of total assets**	**2000**	**% of total assets**
Cash and Short Term Investments	**$ 10.9**	**28.4%**	$ 17.7	30.3%	$ 19.7	35.1%
Accounts Receivable	**12.9**	**33.5%**	17.5	30.0%	15.7	28.0%
Prepaid Expenses	**0.5**	**1.3%**	0.7	1.2%	1.0	1.8%
Production in Progress	**2.9**	**7.5%**	5.1	8.8%	4.9	8.7%
Deferred Development Costs	**1.2**	**3.1%**	1.6	2.8%	1.0	1.8%
Investment in Film and Television Programming	**0.4**	**1.0%**	3.1	5.3%	3.2	5.7%
Capital Assets	**8.8**	**22.9%**	11.5	19.7%	9.5	16.9%
Deferred finance costs	**0.9**	**2.3%**	1.1	1.9%	1.1	1.9%
Total Assets	**38.5**	**100.0%**	58.3	100.0%	56.1	100.0%
Shareholders' Equity	**10.1**		28.1		24.3	

Cash and short-term investments decreased to $10.9 million at March 31, 2002 from $17.7 million at March 31, 2001. The majority of this decrease relates to the operating losses sustained during the year. Accounts Receivable decreased to $12.9 million at March 31, 2002 from $17.5 million at March 31, 2001 commensurate

with the decrease in revenue. The quality of receivables remains high as the majority of the receivables are due from government agencies in the form of tax incentives relating to already completed productions. The decrease in Production in Progress from $5.1 million at March 31, 2001 to $2.9 million at March 31, 2002 is indicative of the reduced activity levels at year-end and the write down discussed earlier.

The decrease in cash and short-term investments from $19.7 million at March 31, 2000 to $17.7 million at March 31, 2001 was partially offset by the decrease in bank indebtedness from $6.1 million at March 31, 2000 to $4.5 million at March 31, 2001. Accounts receivable increased to $17.5 million at March 31, 2001 from $15.7 million at March 31, 2000 commensurate with an increase in revenue. Production in Progress remained relative constant at March 31, 2002 compared to March 31, 2001.

Bank indebtedness increased to $8.6 million at March 31, 2002 from $4.5 million at March 31, 2001 as a result of the Company financing certain tax incentives on productions completed during the year. Accounts Payable decreased significantly to $2.9 million at March 31, 2002 from $4.7 million at March 31, 2001 due to the decreased production activity compared with the previous year. Deferred revenue increased to $2.8 million at March 31, 2002 from $2.5 million at March 31, 2001 and related entirely to advances received for projects that were delivered during Fiscal 2003. Bank indebtedness decreased from $6.1 million at March 31, 2000 to $4.5 million at March 31, 2001 as result of the repayment of certain production facilities. At March 31, 2001 and 2000 accounts payable remained constant at $4.7 million. Deferred revenue decreased from $5.3 million at March 31, 2000 to $2.5 million at March 31, 2001 and related entirely to advances received for projects that were delivered during Fiscal 2002.

DEVELOPMENT COSTS Development costs decreased to $1.2 million at March 31, 2002 from $1.6 million at March 31, 2001. The decrease is due to a write down in the amount of $2.4 million relating to a number of development projects that were abandoned during the year. Projects that remain in development include *Tony Hawk*, *Dots Bots*, and *Betty Boop*.

Development costs increased to $1.6 million at March 31, 2001 from $1.0 million at March 31, 2000. The increase was due to a number of projects developed during the year which the Company planned to produce in the next fiscal year or thereafter. These included Season IV of *ReBoot* which went into production shortly after March 31, 2001. During the year, the Company wrote off $0.2 million of the costs of older projects.

INVESTMENT IN FILM AND TELEVISION PROGRAMMING Investment in film and television programming decreased to $0.4 million at March 31, 2002 from $3.2 million at March 31, 2001. In line with Company policies and based on circumstances that came to light during the year, the Company revalued its investments in film and television programming as discussed earlier. This resulted in a write down of the investments totaling $3.1 million

Investment in film and television programming remained unchanged at $3.2 million at March 31, 2001 and March 31, 2000. The addition of the investment in the direct-to-video *Casper's Haunted Christmas* was offset by the amortization ($0.5 million) of the investments made in prior years.

CAPITAL ASSETS □ Capital assets decreased to $8.8 million at March 31, 2002 from $11.5 million at March 31, 2001. During Fiscal 2002 the Company acquired $0.7 million of capital assets principally related to computer equipment and related software needed for ongoing operations. More significant investment in capital assets in prior years lessened the requirement for current year spending. Depreciation of capital assets for the year ended March 31, 2001 amounted to $3.4 million.

Investment in Capital assets increased to $11.5 million at March 31, 2001 from $9.4 million at March 31, 2000. During Fiscal 2001 the Company acquired $5.3 million of capital assets principally related to computer equipment and related software needed for ongoing operations and included the addition of a motion capture studio. Depreciation of capital assets for the year ended March 31, 2001 amounted to $3.3 million.

CAPITAL LEASE OBLIGATIONS □ Capital lease obligations decreased to $4.2 million at March 31, 2002 from $6.4 million at March 31, 2001 as a result of lease repayments as well as reduced capital spending. Capital lease obligations incurred during Fiscal 2002, principally for computer equipment and related software, amounted to $0.3 million and repayments of existing capital leases amounted to $2.5 million.

Capital lease obligations increased to $6.4 million at March 31, 2001 from $4.6 million at March 31, 2000. Capital lease obligations incurred during Fiscal 2001, principally for computer equipment and related software, amounted to $4.3 million and repayments of existing capital leases amounted to $2.5 million.

DEBENTURES □ Debentures decreased to $22.2 million at March 31, 2002 from $24.3 million at March 31, 2001 due primarily to the fact the Company repaid $3.4 million of the outstanding debentures on June 29, 2001. During Fiscal 2002 the Company issued $1.0 million of convertible debentures in lieu of interest on the debentures issued last year and accretion for the year amounted to $0.7 million. Over the term of the debentures they are accreted up to the amount due on maturity to account for the portion of the debenture that was accounted for as equity on issuance. The balance of the increase in debentures was due to the fluctuation in the CDN vs. U.S. dollar exchange rate at the respective year-end dates.

During the year the maturity date of debentures originally issued on June 30, 1996 was extended from July 15, 2001 to August 31, 2002. In exchange for the extension the Company issued warrants to purchase 170,000 common shares of the Company at an exercise price of $0.50 per share for a term of 12 months from the date of the grant. At maturity the Company has the option to further extend the maturity to November 30, 2002 in exchange for warrants to purchase 100,000 common shares at an exercise price of $0.50 per share for a term of 12 months from the date of the grant (see notes 1 and 9(a) to the Financial Statements).

Debentures increased from $22.2 million at March 31, 2000 to $24.3 million at March 31, 2001. During Fiscal 2001 the Company issued $1.1 million of convertible debentures in lieu of interest on the debentures issued in the previous year and accretion for the year amounted to $0.6 million.

SHAREHOLDERS' EQUITY □ Shareholders' equity decreased from $28.1 million at March 31, 2001 to $10.1 million at March 31, 2002 as a result of the net loss for the year.

Shareholders' equity increased to $28.1 million at March 31, 2001 from $24.3 million at March 31, 2000 as a result of the net earnings for the year and the accretion on the convertible debentures.

ADDITIONAL FINANCING □ In July 2002 the Company renewed its revolving credit facility with its primary bank, which provides up to $16.5 million in production financing, capital leasing facilities which are fully utilized and $1 million in demand operating loans.

Based on current projections of funding requirements the Company believes this facility will be sufficient to fund the Company's activities for the balance of the current fiscal year.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING AND AUDITORS' REPORT

Wubbies World

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements of the Company have been prepared by management in accordance with accounting principles generally accepted in Canada, and contain estimates based on management's judgement. Management maintains an appropriate system of internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded, and proper records are maintained.

The Audit Committee of the Board of Directors, which is composed of a majority of independent directors, has met with the Company's independent auditors to review the scope and results of the annual audit, and to review the consolidated financial statements and related financial reporting matters prior to submitting the consolidated financial statements to the Board for approval.

The Company's independent auditors, PricewaterhouseCoopers LLP, are appointed by the shareholders to conduct an audit in accordance with generally accepted auditing standards, and their report follows.

George Lawton
Chief Financial Officer

AUDITORS' REPORT

TO THE SHAREHOLDERS OF MAINFRAME ENTERTAINMENT, INC. We have audited the consolidated balance sheets of Mainframe Entertainment, Inc. as at March 31, 2002 and 2001 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2002 and 2001 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles. As required by the British Columbia Company Act, we report that, in our opinion, these principles have been applied on a consistent basis.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants
Vancouver, B.C.
June 5, 2002

CONSOLIDATED BALANCE SHEETS AS AT MARCH 31, 2002 AND 2001

(in thousands of dollars)	2002	2001
Assets		
Cash and cash equivalents (notes 3 and 7)	$ 10,882	17,733
Accounts receivable (note 4)	12,910	17,460
Prepaid expenses	495	691
Productions in progress (note 5)	2,844	5,168
Development costs	1,217	1,591
Investment in film and television programming	350	3,158
Property and equipment (note 6)	8,812	11,484
Deferred finance costs	944	1,053
	$ 38,454	58,338
Liabilities		
Bank indebtedness (note 7)	$ 8,614	4,471
Accounts payable and accrued liabilities	3,060	4,742
Deferred revenue	2,790	2,483
Capital lease obligations (note 8)	4,206	6,372
Debentures (note 9)	9,641	12,189
	28,311	30,257
Shareholders' Equity		
Capital stock (note 10)	45,727	45,727
Contributed surplus	499	-
Debentures (note 9)	12,586	12,119
Warrants (note 12)	21	-
Deficit	(48,690)	(29,765)
	10,143	28,081
	$ 38,454	58,338

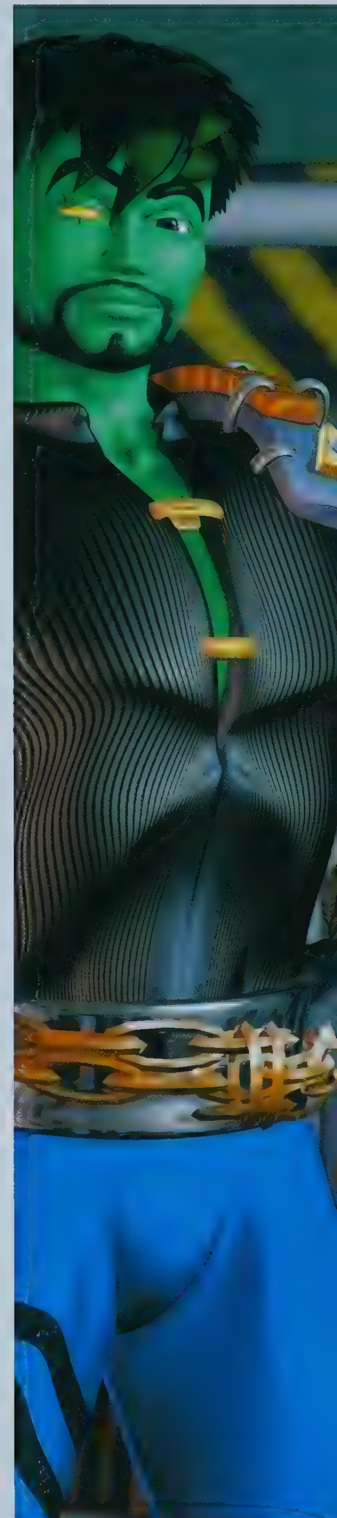
Nature of operations and going concern (note 1)
Commitments (note 18)

Approved by the Board of Directors

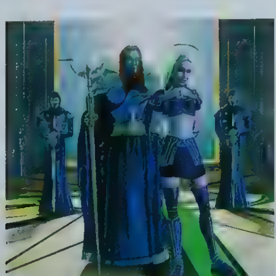
Brett Gannon
Director

Mark Ralston
Director

CONSOLIDATED STATEMENTS OF EARNINGS AND DEFICIT FOR THE YEARS ENDED MARCH 31, 2002 AND 2001



(in thousands of dollars, except per share information)	**2002**	2001
Revenue	**$ 22,465**	$ 39,942
Expenses		
Production costs	**21,081**	27,208
Selling, general and administrative	**4,866**	4,515
Amortization	**4,581**	4,306
Interest on capital leases	**399**	384
Interest on debentures (note 9)	**389**	405
Other expenses (income)	**176**	(387)
Writedown of investment in film and television programming	**8,434**	258
	39,926	36,689
(Loss) net earnings for the year before the undernoted	**(17,461)**	3,253
Interest and accretion on convertible debentures (note 9)	**(1,464)**	(826)
(Loss) net earnings attributable to common shareholders	**(18,925)**	2,427
Deficit - Beginning of year	**(29,765)**	(32,192)
Deficit - End of year	**$ (48,690)**	$ (29,765)
Basic and diluted (loss) earnings per share attributable to common shareholders (note 13)	**(1.11)**	0.14



CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED MARCH 31, 2002 AND 2001

(in thousands of dollars)	2002	2001
Cash flows from operating activities		
(Loss) net earnings for the year	$ (17,461)	$ 3,253
Items not affecting cash		
Writedown of investment in film and television programming	8,434	258
Other amortization	479	968
Amortization of capital assets	3,406	3,321
Contributed surplus on repayment of debentures	499	-
Capitalized interest and unrealized foreign exchange on debentures	383	1,247
Investment in film and television programming	(970)	(2,135)
Development costs	(1,427)	(813)
	(6,657)	6,099
Changes in non-cash operating items		
Accounts receivable	4,550	(1,724)
Prepaid expenses	196	270
Productions in progress	(1,132)	1,383
Accounts payable and accrued liabilities	(1,682)	83
Deferred revenue	307	(2,829)
	2,239	(2,817)
	(4,418)	3,282
Cash flows from financing activities		
Capital lease repayments	(2,463)	(2,510)
Capital lease proceeds	297	4,331
Repayment of debentures	(3,382)	-
Increase in bank indebtedness	4,143	(1,622)
	(1,405)	199
Cash flows from investing activities		
Property and equipment acquired and financed under capital lease agreements	(297)	(4,331)
Purchase of property and equipment	(437)	(1,019)
Deferred finance costs	(294)	(400)
Employee loan	-	300
	$ (1,028)	$ (5,450)
Decrease in cash and cash equivalents	(6,851)	(1,969)
Cash and cash equivalents - Beginning of year	17,733	19,702
Cash and cash equivalents - End of year	$ 10,882	$ 17,733
Interest paid in the year	$ 769	$ 871
Taxes paid in the year	$ 117	$ 196
Interest and accretion on convertible debenture recorded in film and television programming	$ 768	$ 836

Supplemental cash flow information (note 16)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2002 AND 2001

(all tabular amounts in thousands of dollars)

1.NATURE OF OPERATIONS AND GOING CONCERN

Mainframe Entertainment Inc. (the Company) develops, produces and exploits computer-generated animation television series, direct-to-video films, feature films and ancillary products.

These consolidated financial statements have been prepared on a going concern basis, which assumes the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future, to fund its planned production under its development and production agreement with Imax (note 5), and that the Company renegotiates an additional extension on the repayment of the 1996 debentures (note 9(a)) or obtains additional financing. The Company has been successful in obtaining additional financing and an extension on the repayment of the debentures in the past; however, there can be no assurance that it will be successful in the future. These consolidated financial statements do not reflect adjustments to the carrying values of assets and liabilities that would be necessary if the Company were unable to operate in the normal course.

2.SIGNIFICANT ACCOUNTING POLICIES

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP).

PRINCIPLES OF CONSOLIDATION These consolidated financial statements include the accounts of the Company and its wholly owned and controlled subsidiaries. All intercompany balances and transactions have been eliminated.

CHANGE IN ACCOUNTING POLICY In June 2000, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants (AICPA) issued Statement of Position 00-2 (SOP 00-2), "Accounting by Producers or Distributors of Films". SOP 00-2 supercedes Statement of Financial Accounting Standards No. 53, "Financial Reporting by Producers and Distributors of Motion Picture Films" establishing new accounting standards on revenue recognition, capitalization and amortization of film costs, accounting for exploitation costs, including advertising and marketing expenses, and presentation and disclosure of related information in financial statements.

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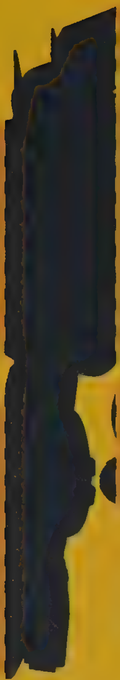


The Company has elected to adopt the guidance in SOP 00-2 commencing with its year ended March 31, 2002 and has applied the change retroactively. Prior years' financial statements have not been restated as the effects of the change in accounting policy on the consolidated statement of operations were not material.

REVENUE RECOGNITION Revenue is derived from television or theatrical and other special productions and from the sale of related distribution, merchandising and licensing rights.

Revenues from production and distribution licence agreements, which may provide for the receipt of non-refundable minimum guaranteed amounts, are recognized when the licence period begins and the programming is available for showing pursuant to the terms of the agreement, typically when the finished product has been delivered and accepted by the licensee.

Revenues from merchandising and licensing contracts for the sale of related rights are recognized when the contracts are executed and guaranteed minimum amounts are known and collectible. Amounts receivable in excess of non-refundable guaranteed amounts, royalties and other contractual payments are recognized as revenue when the amounts are known and become due.

Revenue is recognized only to the extent that collectibility is reasonably assured; contributions or other payments received or receivable, and not yet recognized as revenue, are included in deferred revenue.

PRODUCTIONS IN PROGRESS Costs of producing television episodes and other productions are capitalized and either charged against revenues generated by the delivery of those episodes or productions or, for proprietary productions, transferred following completion to investment in film and television programming. Costs are assessed at each balance sheet date for recoverability and costs in excess of their estimated recoverable amount are written off in the period in which such an assessment is made.

INVESTMENT IN FILM AND TELEVISION PROGRAMMING Investment in film and television programming represents the unamortized cost of completed proprietary film and television programs (net of related tax credits received or receivable) which have been produced by the Company or to which the Company has acquired distribution rights.

For episodic television series, capitalized costs are limited to the amount of revenue contracted for each episode until estimates of secondary market revenue can be established. Costs in excess of this limitation are expensed as incurred.

Participation and exploitation costs are capitalized when they are likely to be incurred and can be reasonably determined.

The Company records amortization based on the ratio that current revenues bear to estimated remaining unrecognized ultimate revenue as of the beginning of the current fiscal year. Investment in film and television programming is recorded at the lower of remaining unamortized costs and estimated fair value, determined on an individual program basis.

Estimates of ultimate revenue to be received in respect of a particular program includes revenue from a market or territory only when persuasive evidence exists that such revenue will occur, or the Company has a history of earning such revenue in the market or territory.

DEVELOPMENT COSTS Development costs represent expenditures incurred on projects prior to production. Advances or contributions received from third parties to assist in development are deducted from these expenditures. Upon commencement of production, development costs directly related to a production are charged to the production. Development costs are written off if the property has been held for three years and has not been set for production or earlier when projects under development are abandoned.

The ability of the Company to recover development costs is subject to uncertainty and is dependent on the ability of the Company to successfully produce, market and distribute the ultimate programming. While management believes its estimates of the ultimate recovery of development costs to be appropriate based on information currently available, it is possible that these estimates may change in the near term by material amounts.

DEFERRED FINANCE COSTS The direct costs associated with the issue of debentures are deferred and amortized over the term of the debentures.

CASH AND CASH EQUIVALENTS Cash and cash equivalents consist of cash on deposit and highly liquid short-term interest-bearing securities with maturities at the date of purchase of three months or less.

PROPERTY AND EQUIPMENT Property and equipment are recorded at cost less accumulated amortization. Amortization is charged over the estimated useful lives of the assets and is calculated from the time the assets are placed in service, using the following rates and methods:

Computer and production equipment	30% declining balance
Computer software	33.3% declining balance
Office furniture and fixtures	20% declining balance
Leasehold improvements	straight-line over term of lease

GOVERNMENT FINANCING AND ASSISTANCE The Company has access to several Canadian government programs that are designed to assist research and development of new technologies, and film and television production and distribution. Amounts received for production assistance are recorded as revenue in accordance with the Company's revenue recognition policy for completed productions. Government assistance towards current expenses is included in the determination of earnings or loss for the year.

FOREIGN CURRENCY Monetary assets and liabilities denominated in currencies other than Canadian dollars are translated at exchange rates in effect at the balance sheet date. Revenue and expense items are translated at average rates of exchange for the year. Translation gains and losses are included in the determination of earnings,

except for exchange gains or losses related to foreign currency denominated monetary items with a fixed or ascertainable life extending beyond the end of the following fiscal year; these are deferred and amortized on a straight-line basis over the remaining life of the monetary item.

LEASES Leases that transfer substantially all of the benefits and risks of ownership of the property are recorded as an asset, and the obligation incurred as a liability. Under this method of accounting for leases, the asset is depreciated over its estimated useful life and the obligation is liquidated over the term of the lease. Costs incurred under operating leases are expensed as incurred.

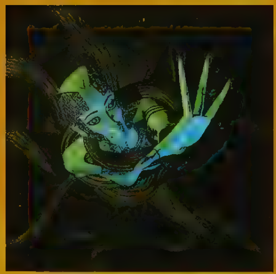
FINANCIAL INSTRUMENTS Financial instruments are classified in accordance with the substance of the contractual arrangement. Financial liabilities, which are defined as any contractual obligation to deliver cash or another financial asset to another party, are classified as liabilities.

STOCK OPTIONS No expense is recognized when stock options are issued. Any consideration paid by option holders on exercise of stock options is credited to capital stock.

USE OF ESTIMATES The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

INCOME TAXES Future income taxes are computed using the liability method whereby future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment or enactment occurs. To the extent that the Company does not consider it to be more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

COMPARATIVE FIGURES Certain of the prior year figures have been reclassified to conform to the presentation adopted in the current year.



3.CASH AND CASH EQUIVALENTS

Cash deposits of $509,278 (2001 - $529,000) were provided as collateral for a letter of credit issued under the terms of a lease agreement. These deposits will be released on January 1, 2004.

Cash deposits of $nil (2001 - $6,507,000) have been restricted to finance a specific production under the agreement between Imax Corporation (Imax) and the Company (note 19).

Cash deposits of $nil (2001 - $968,000) have been restricted to finance current and future productions.

See also note 7.

4.ACCOUNTS RECEIVABLE

(in thousands of dollars)	**2002**	2001
Tax credits receivable	**$ 12,217**	9,852
Trade receivables - net (note 19)	**254**	6,616
Other	**439**	992
	$ 12,910	17,460

5.PRODUCTIONS IN PROGRESS

Included in productions in progress is the Company's proportionate share of the costs incurred pursuant to a development and production agreement entered into with Imax. Under the agreement, the Company has committed to produce a minimum of three 70-mm format films. The Company and Imax will each fund 50% of the production costs, not to exceed US$14,000,000 for the first production. Any excess production cost over an approved budget is to be funded by the Company. Gross proceeds from the productions are to be shared equally between Imax and the Company, with the exception of the first production, which is to be allocated as follows:

a) for proceeds up to US$1,300,000 greater than budget, 54% to Imax and 46% to the Company
b) for proceeds in excess of US$1,300,000 greater than budget, 52% to Imax and 48% to the Company.

The Company capitalized net interest and accretion on debentures of $1,435,046 (2001 - $1,215,000) to productions in progress, prior to the impairment charge noted below.

During the year ended March 31, 2002, the Company determined that certain costs capitalized to productions in progress were impaired and these costs were written down in the amount of $2,908,675 and charged to production costs.

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6 PROPERTY AND EQUIPMENT

(in thousands of dollars)

2002	Cost	Accumulated amortization	Net
Owned assets			
Computer and production equipment	$ 10,401	$ 8,594	$ 1,807
Computer software	2,502	1,803	699
Office furniture and fixtures	818	465	353
Leasehold improvements	2,747	1,068	1,679
Tenant inducements	(1,541)	(424)	(1,117)
	14,927	11,506	3,421
Leased assets			
Computer and production equipment	13,508	9,159	4,349
Computer software	2,060	1,555	505
Office furniture and fixtures	370	153	217
Leasehold improvements	390	70	320
	16,328	10,937	5,391
	$ 31,255	$ 22,443	$ 8,812

2001	Cost	Accumulated amortization	Net
Owned assets			
Computer and production equipment	$ 10,368	$ 8,166	$ 2,202
Computer software	2,323	1,519	804
Office furniture and fixtures	788	381	407
Leasehold improvements	2,726	952	1,774
Tenant inducements	(1,541)	(554)	(987)
	14,664	10,464	4,200
Leased assets			
Computer and production equipment	13,353	7,345	6,008
Computer software	1,986	1,303	683
Office furniture and fixtures	369	99	270
Leasehold improvements	394	71	323
	16,102	8,818	7,284
	$ 30,766	$ 19,282	$ 11,484

Amortization for the year ended March 31, 2002 on property and equipment held under capital leases amounted to $2,118,635 (2001 - $2,129,242).

7. BANK INDEBTEDNESS

The Company has been provided a credit facility from a Canadian bank, the substantive details of which are as follows:

a) $1,000,000 facility to be utilized for purposes of a demand operating loan, letters of credit or letters of guarantee

b) lease facility line of credit which is fully utilized (note 8)

c) $16,500,000 single purpose film production facility.

In connection with this bank indebtedness, the Company has granted a collateral interest in all of its assets and has agreed to provide a cash balance of $2,500,000 to be held by the bank as security, to maintain certain financial ratios and to restrict certain borrowings.

8. CAPITAL LEASE OBLIGATIONS

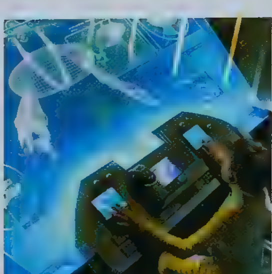
Under the terms of the bank credit facility (note 7), the Company has entered into capital lease obligations payable in equal monthly instalments of approximately $210,000, including principal and interest at rates up to 8.5% per annum, maturing from September 2002 to January 2005. In connection with these leases, the Company has granted a collateral interest in all of its assets and has agreed to maintain certain financial ratios and to restrict certain borrowings and debt repayments.

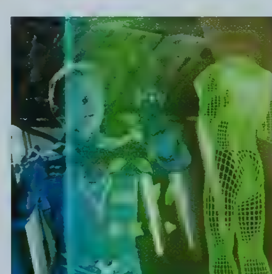
Aggregate future minimum lease payments under capital lease agreements are as follows:

(in thousands of dollars)

Year ending March 31, 2003	$	2,344
2004		1,906
2005		316
		4,566
Less: Amount representing future interest		360
	$	4,206

During the year ended March 31, 2002, the Company paid $399,000 (2001 - $384,000) in interest on capital leases.





9 DEBENTURES

(in thousands of dollars)

				2002
		Debt	**Equity**	**Total**
Convertible subordinated debentures, US$3.1 million bearing interest at 8% per annum	(a)	$ 4,944	$ -	**$ 4,944**
Convertible unsecured subordinated debentures, $10.4 million bearing interest at 6% per annum	(b)	-	11,133	**11,133**
Convertible senior secured debentures, $5.7 million bearing interest at 6% per annum	(c)	4,697	1,453	**6,150**
		$ 9,641	$ 12,586	**$ 22,227**

				2001
		Debt	**Equity**	**Total**
Convertible subordinated debentures, US$3.1 million bearing interest at 8% per annum	(a)	$ 4,875	$ -	**$ 4,875**
Convertible unsecured subordinated debentures, $9.8 million bearing interest at 6% per annum	(b)	-	10,229	**10,229**
Convertible senior secured debentures, $8.7 million bearing interest at 6% per annum	(c)	7,314	1,890	**9,204**
		$ 12,189	$ 12,119	**$ 24,308**

a) These debentures, originally issued on June 30, 1996 are convertible into common shares of the Company at a price of US$5.455 per share. Interest is payable in cash semi-annually. The debentures convert automatically into common shares if the Company's shares trade at a price greater than US$10 (or the equivalent price in Canadian dollars) per share. On automatic conversion, accrued and unpaid interest up to the conversion date is payable in cash. The debentures are subordinated to all existing or future bank indebtedness of the Company under a bank secured credit facility, guarantees on bank indebtedness provided by the Company, and obligations of the Company under capital lease, as well as the 6% senior secured debentures.

During the year ended March 31, 2002, the maturity date of these debentures was extended from July 15, 2001 to August 31, 2002. In exchange for the extension, the Company issued warrants to purchase 170,000 common shares of the Company at an exercise price of $0.50 per share for a term of 12 months from the date of the grant.

At August 31, 2002 the Company has the option to extend the maturity to November 30, 2002 in exchange for warrants to purchase 100,000 common shares at an exercise price of $0.50 per share for a term of 12 months from the date of the grant.

The equity component of these debentures was not considered material at the time of issue and therefore the debentures have not been split into their debt and equity components on the consolidated balance sheet. The effect of classifying the amounts recorded for related financing and interest costs and foreign exchange translation amounts into their debt and equity components is not considered to be material.

b) On July 20, 1999, the Company issued $9,000,000 of convertible unsecured subordinated debentures maturing June 30, 2009. Interest is payable semi-annually in cash or in additional convertible unsecured subordinated debentures. The Company has the right to redeem all, but not less than all, of the principal amount (together with any accrued but unpaid interest) of the debentures at any time upon 30 days' prior notice, subject to redemption premiums payable if the debentures are redeemed on or before June 30, 2003. The Company can satisfy the redemption price by delivering either cash or common shares of the Company. The debentures are convertible at the holder's option into common shares at $2.50 per share.

These convertible debentures have been split between long-term debt and a fixed equity component. However, the Company has the option of satisfying both its principal and interest components of the convertible debentures by way of issuing common shares. As a result, both the debt and equity components of these debentures have been classified as equity. Interest paid or accrued will be accounted for on an ongoing basis by way of a charge to deficit. The debt component is being increased through a charge to deficit as its present value increases.

During the year ended March 31, 2002, the Company issued $594,000 (2001 - $499,000) of convertible debentures in satisfaction of interest payments.

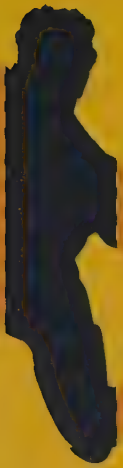
c) On July 20, 1999, the Company issued $8,000,000 of convertible senior secured debentures maturing June 1, 2004. On June 29, 2001 the Company repaid $3,381,780 of the outstanding debentures and transferred the equity portion to contributed surplus. Interest is payable semi-annually in cash or in additional convertible senior secured debentures. The debentures are redeemable by the Company, in whole or in part, on or after June 1, 2002, only if the 20-day weighted average trading price of the Company's common shares is not less than $4.75 per share. The debentures are convertible at the holder's option into common shares at $3.00 per share.

The debentures are subordinated to all existing or future bank indebtedness of the Company under a bank secured credit facility, future bank indebtedness in respect of production financing or capital leases, and an unsecured revolving credit line. The Company has granted a second charge (behind only the bank debt) on all real and personal property of the Company as collateral for the debentures.

These convertible debentures have been split between long-term debt and a fixed equity component. The debt component has been calculated as the present value of the required interest and principal payments discounted at a rate approximating the rate that would have been applicable to non-convertible debt at the time the debentures were issued. The debt component is being increased through a charge to interest expense as its present value increases. Future convertible debentures issued in satisfaction of interest payments will be treated similarly if the split between debt and equity is material.

During the year ended March 31, 2002, the Company issued $443,000 (2001 - $561,000) of convertible debentures in satisfaction of interest payments.

The terms of the convertible debentures contain certain restrictive covenants that may operate to limit the ability of the Company to sell, lease, transfer or exchange its material assets; enter into material contracts outside the Company's ordinary course of business; grant a charge or security interest in the material assets of the Company; incur certain types of debt; or incur certain levels of capital expenditure.



10.CAPITAL STOCK

AUTHORIZED

Unlimited number of common shares without par value

(in thousands of dollars)	Number of shares	Amount
Issued		
Balance - March 31, 2000	17,083,195	$ 45,427
Repayment of Advance	-	300
Balance - March 31, 2001 and 2002	17,083,195	$ 45,727

11.COMMON STOCK OPTIONS

The Company maintains a stock option plan enabling certain directors, officers and employees of the Company to purchase in the aggregate up to 2,600,000 common shares pursuant to options that may be granted by the board of directors in its discretion under the plan. The plan complies with rules set forth for such plans by the Toronto Stock Exchange (TSE) and provides for the issuance of options to directors, officers, consultants and senior full-time and part-time employees of the Company. The options are non-assignable, may be granted for terms of up to 10 years by the board at an exercise price not less than the closing price on the TSE of the common shares on the date immediately prior to the grant of the option.

The Company has also granted stock options outside the plan noted above.

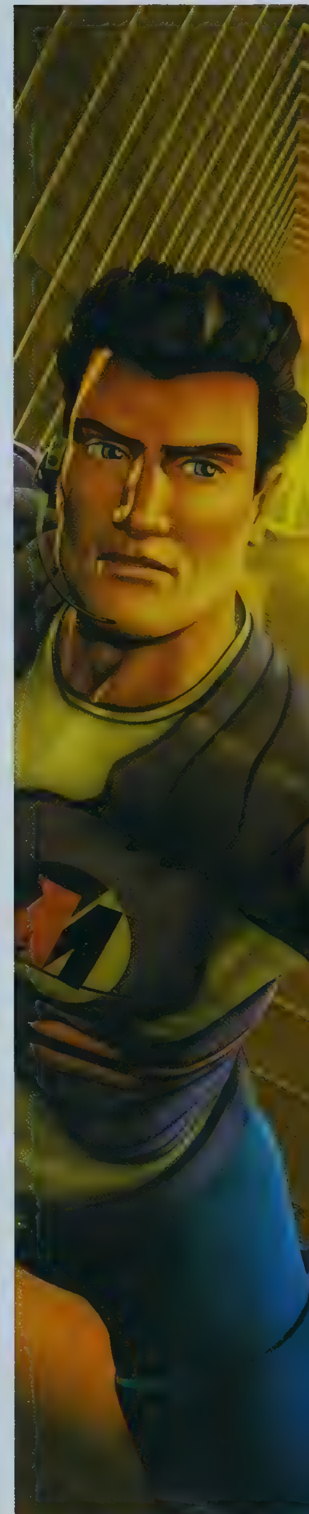
A summary of the status of the Company's stock option plan as at March 31, 2002 and 2001, and changes during the years ending on these dates is presented below:

Action Man

	Number of options	Weighted average exercise price per share
Outstanding - March 31, 2000	823,975	$ 7.35
Granted	385,000	$ 2.25
Cancelled	(32,900)	$ 9.75
Outstanding - March 31, 2001	1,176,075	$ 4.28
Granted	1,068,900	$ 0.50
Cancelled	(240,000)	$ 2.12
Expired	(71,875)	$ 9.57
Outstanding - March 31, 2002	1,933,100	$ 1.94

As at March 31, 2002, the Company had the following stock options outstanding:

	Options outstanding			Options exercisable	
Range of exercise prices per share	**Number outstanding at March 31, 2002**	**Weighted average remaining contractual life** (years)	**Weighted average exercise price per share**	**Number exercisable at March 31, 2002**	**Weighted average exercise price per share**
$ 0.50	$ 1,315,000	4.7	$ 0.50	$ 603,056	$ 0.50
2.25	293,100	1.8	2.25	243,100	2.25
2.60	75,000	0.2	2.60	75,000	2.60
9.75	250,000	0.2	9.75	250,000	9.75
$ 0.50 - 9.75	$ 1,933,100	3.51	$ 1.94	$ 1,171,156	$ 2.90



12.WARRANTS

In connection with the extension of the debentures issued in 1996 (note 9(a)), the Company issued 170,000 share purchase warrants. Each share purchase warrant allows the holder to acquire one common share of the Company at an exercise price of $0.50 per share. The issued warrants will expire February 28, 2003. The value attributed to the warrants was estimated utilizing the Black-Scholes valuation model.

13.EARNINGS (LOSS) PER SHARE ATTRIBUTABLE TO COMMON SHAREHOLDERS

During the year the Company adopted, on a retroactive basis, the new recommendations of the CICA with respect to the presentation and computation of earnings per share. The new recommendations require the presentation of earnings per share to be computed using the treasury stock method in determining the dilutive effect of warrants and options. For the years ended March 31, 2002 and 2001, the application of the new recommendations had no impact on the earnings per share figures.

Basic earnings (loss) per common share is calculated by dividing the net earnings (loss) attributable to common shareholders for the period by the weighted average number of common shares outstanding during the period.

Diluted earnings (loss) per common share is computed similar to basic net earnings (loss) per share except that the weighted average shares outstanding are increased to include additional shares from the assumed exercise or conversion of stock options, warrants, and convertible securities using the treasury stock method, if dilutive.

14.INCOME TAXES

The Company and its subsidiaries have estimated non-capital losses for Canadian income tax purposes of approximately $16,556,000 at March 31, 2002. These losses may be carried forward against future taxable income and will expire in the following years:

(in thousands of dollars)

2003	$ 304
2004	2
2005	1,983
2006	8,246
2007	582
2008	494
2009	4,945
	$ 16,556

As at March 31, 2002 the Company has non-capital losses for U.S. income tax purposes of approximately US$459,672 (CDN$729,500) which are available for carry-forward to reduce future years' taxable income of the U.S. Company.

(in thousands of dollars)	**2002**	2001
Future income tax assets		
Temporary differences	**$ 6,543**	$ 10,313
Operating losses available for future periods	**6,175**	7,111
Gross future income tax assets	**12,718**	17,424
Valuation allowance	**(12,718)**	(17,424)
	$ -	$ -

Management believes there is sufficient uncertainty regarding the realization of a future income tax asset such that a full valuation allowance has been provided.

The income tax provisions for the years ended March 31, 2002 and 2001 have been reduced from the applicable statutory income tax rate to $nil primarily as a result of the excess of deductions for tax purposes over accounting charges related to capital assets and film and development costs.

15. FINANCIAL INSTRUMENTS AND CONCENTRATION OF RISK

A) FINANCIAL INSTRUMENTS Financial instruments comprise cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, capital lease obligations, and debentures. These instruments are carried at historical cost or historical issue price, except for accounts receivable, which are carried at cost less an allowance for doubtful accounts. Given the nature of convertible debentures issued by the Company, management believes that their carrying amounts approximate fair values. All other financial instruments have been recently issued or obtained; accordingly, management believes that the carrying amounts approximate fair values.

B) CREDIT RISK Financial instruments that potentially subject the Company to concentration of credit risk consist principally of temporary cash investments and trade receivables.

The Company places its temporary cash investments with major Canadian chartered banks or high quality credit financial institutions. Original maturities of these deposits or investments are three months or less, and, therefore, the investments are believed to be subject to minimal risk.

Trade receivables arise primarily from distribution, merchandising and licensing agreements with third parties and from refundable federal and provincial tax credits. Payments for distribution rights or production services are generally advanced to the Company prior to delivery of productions and are included in deferred revenue. The Company periodically monitors the financial condition of the third parties with whom it has entered into distribution agreements and merchandising and licensing agreements, and generally pursues settlement of amounts due on a timely basis. Collateral for amounts receivable is generally not required. Credit losses are not considered excessive and have been within management's expectations.

16. SUPPLEMENTAL CASH FLOW INFORMATION

During the year ended March 31, 2002, the Company settled interest payments of $1,037,000 (2001 - $1,059,000) on certain convertible debentures by issuing additional convertible debentures. In addition, the Company recorded accreted interest of $692,000 (2001 - $601,000) on the same debentures.

17.SEGMENT REPORTING

The Company operates in one segment comprising the production and exploitation of computer-generated film and television properties primarily in Canada, the U.S. and other foreign countries.

(in thousands of dollars)	Revenue 2002	Revenue 2001
Segment		
Production	**$ 21,077**	$ 38,364
Merchandising and licensing	**695**	781
Interest	**693**	797
	22,465	39,942

Revenues by geographical source areas are as follows:

(in thousands of dollars)	Revenue 2002	Revenue 2001
Canada	**4,966**	6,354
U.S.A.	**17,358**	33,325
Other foreign countries	**141**	263
	22,465	39,942

The Company's expenses are incurred mostly in generating production revenue in Canada. The expenditures relating to all other revenue is not considered material and therefore has not been classified separately. Substantially all capital assets are held in Canada.

SIGNIFICANT CUSTOMERS The Company's customers are substantially in the entertainment and merchandising sectors. In the year ended March 31, 2002, the Company earned revenues from three significant customers in the amount of $16,451,756 (or 73% of total revenues earned) (2001 - three significant customers, $38,115,418, 95%).

18.COMMITMENTS

a) The Company is committed to operating leases for two office premises. These leases expire on December 31, 2004 and 2008. The minimum payments under the terms of these leases are as follows:

(in thousands of dollars)	
Year ending March 31, 2003	1,542
2004	1,549
2005	1,679
2006	1,560
2007	1,560
	7,890

b) Other commitments are disclosed elsewhere in these consolidated financial statements.

19.RELATED PARTY TRANSACTIONS AND BALANCES

Transactions with related parties and balances owing are considered by management to be on normal commercial terms and are recorded at the exchange amounts.

Accounts receivable include shareholder loans of $nil (2001 - $246,000) which are unsecured and payable on demand.

Other related party transactions are disclosed elsewhere in these consolidated financial statements.

CORPORATE INFORMATION

OFFICERS

Brett Gannon
President, Mainframe Entertainment, Inc.

Mark Fleischer
President, Mainframe USA

George Lawton
Chief Financial Officer

Phil Mitchell
Vice President, Operations and Development

Kim Dent Wilder
Vice President, Productions

Dave Fracchia, PhD
Vice President, Software Development

Greg Story
Vice President, Technical Operations

DIRECTORS

Brett Gannon
Officer of the Company

Yad Garcha
Senior Vice President, Investments, GrowthWorks Capital Ltd.

Richard L. Gelfond
Co-Chairman & Co-CEO, Imax Corporation

Mark Ralston
Businessman

Bradley J. Wechsler
Co-Chairman & Co-CEO, Imax Corporation

CORPORATE HEADQUARTERS & STUDIO

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AUDITORS

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Vancouver, British Columbia

BANKERS

Royal Bank of Canada
Vancouver, British Columbia

SHARES LISTED

The Toronto Stock Exchange
under the trading symbol "MFE"

REGISTRAR AND TRANSFER AGENT

CIBC Mellon Trust Company
Vancouver, British Columbia

ANNUAL GENERAL MEETING

The Annual General Meeting of the Company will be held at the Company's corporate headquarters at 2025 West Broadway, Vancouver, British Columbia at 10:00 a.m. on September 19, 2002

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MAINFRAME ENTERTAINMENT, INC.

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